

Minnesota Department of Finance

October 2006

Strong Corporate Tax Receipts Lift Revenues Above Forecast

Net non-dedicated general fund revenues totaled \$3.380 billion during the first quarter of fiscal 2007, \$73 million (2.2 percent) more than end-of-session estimates. Net receipts from the corporate franchise tax exceeded the forecast by \$76 million, or 33 percent. Net corporate tax receipts for the July through September quarter were more than 40 percent more than in the prior quarter when corporate estimated payments were \$11 million below forecast.

Summary of Tax Receipts: (July – September, 2006)

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	----- (\$ in millions) -----			
Income	\$1,648	\$1,648	—	—
Sales	990	973	(17)	(1.7)
Corporate	233	309	76	32.6
Motor Vehicles	66	68	2	3.0
Other	<u>370</u>	<u>382</u>	<u>12</u>	<u>3.2</u>
Total	\$3,306	\$3,380	\$73	2.2

Corporate tax managers appear to be anticipating strong corporate profits for the remainder of this tax year. Corporate declarations (estimated payments), during the past quarter were \$72 million above forecast (see page 4). Variances in corporate miscellaneous payments and refunds were small. Individual income tax receipts were almost exactly on forecast for the quarter, while net sales tax receipts continued to fall below projections. Gross sales tax receipts were \$25 million, (2.4 percent) less than forecast. Gross sales tax receipts have been below forecast in 6 of the 7 months since February's forecast. Stronger than anticipated investment income and modest positive variances in the estate tax and the mortgage and deed tax were the primary sources of the additional other revenues.

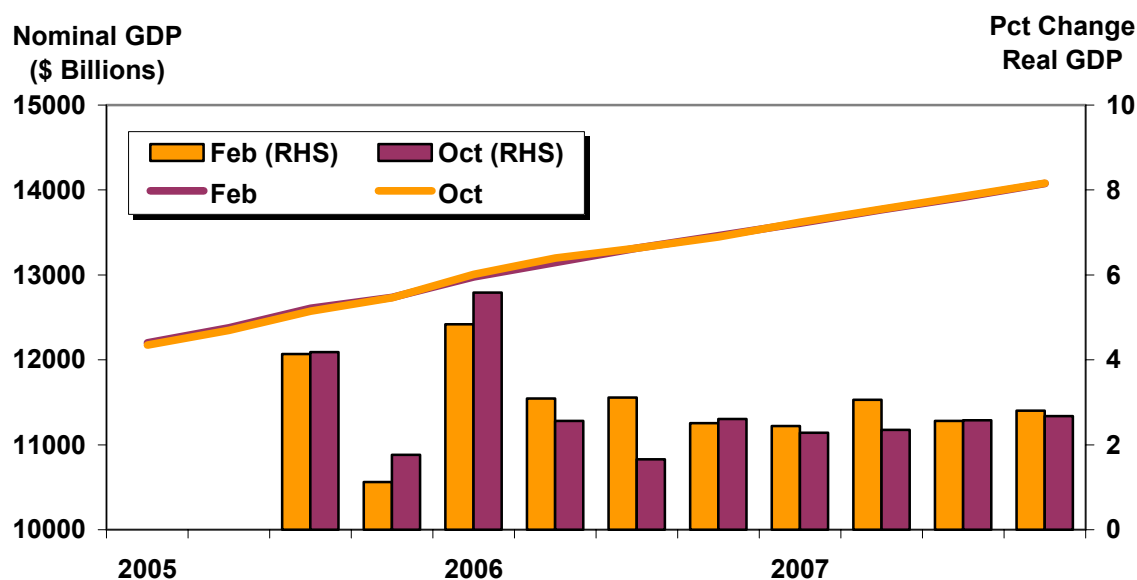
Net non-dedicated general fund revenues for fiscal year 2006 are now reported to be \$451 million above forecast, \$4 million more than reported in July's *Economic Update*. Small reductions in the estimated variance for the individual income tax and the sales tax were more than offset by changes to cigarette and tobacco tax receipts and to departmental earnings.

Slower Real Economic Growth, More Inflation Expected for U.S. Economy

The economy is slowing, and conflicting economic signals are apparent to everyone. The good news is that gasoline prices are down more than 25 percent from the \$3 plus per gallon rates seen in mid-summer. Heating oil, diesel, and natural gas prices also are well below last year's levels. That will free up some discretionary income for consumers to spend on non-energy items. The stock market also has been a source of good news, and the Federal Reserve's interest rate hikes appear to be over. But, housing prices appear to be falling and residential construction has definitely turned down. Housing is now expected to be a drag on the economy through at least mid 2007. Construction employment is likely to drop and some additional fallout is likely since growth in home equity has helped support other consumer spending. September's U.S. payroll employment growth also was disappointing.

Most forecasters expect the weakness in the housing sector to limit the economy's growth through the end of 2007. But, they also believe that the combination of lower interest rates and lower energy prices will keep us from a recession. Global Insight Inc., (GII), Minnesota's national economic consultant, believes real GDP growth in 2007 will be the slowest since 2002. GII now expects real GDP to grow at a 2.6 percent annual rate in 2007. February's baseline forecast called for growth of 3.0 percent. Inflation appears to be back under control, but higher than anticipated in February's forecast. CPI growth of 2.2 percent is now projected for 2007. In February CPI growth of 1.8 percent was expected. The expected higher inflation rate leaves the current dollar GDP forecast almost unchanged.

Slower Real GDP Growth Now Forecast



Global Insight's forecast for real GDP growth in 2007 is identical to the Blue Chip consensus estimate. The Blue Chip panel expects slightly more inflation, projecting CPI growth at a 2.5 percent rate. GII continues to assign a probability of 55 percent to their baseline forecast, the same as in February. A more pessimistic scenario which has the economy slowing to a real growth rate of less than 1.0 percent for three consecutive quarters in late 2006 and early 2007 is assigned a probability of 20 percent. A more optimistic scenario is given a probability of 25 percent.

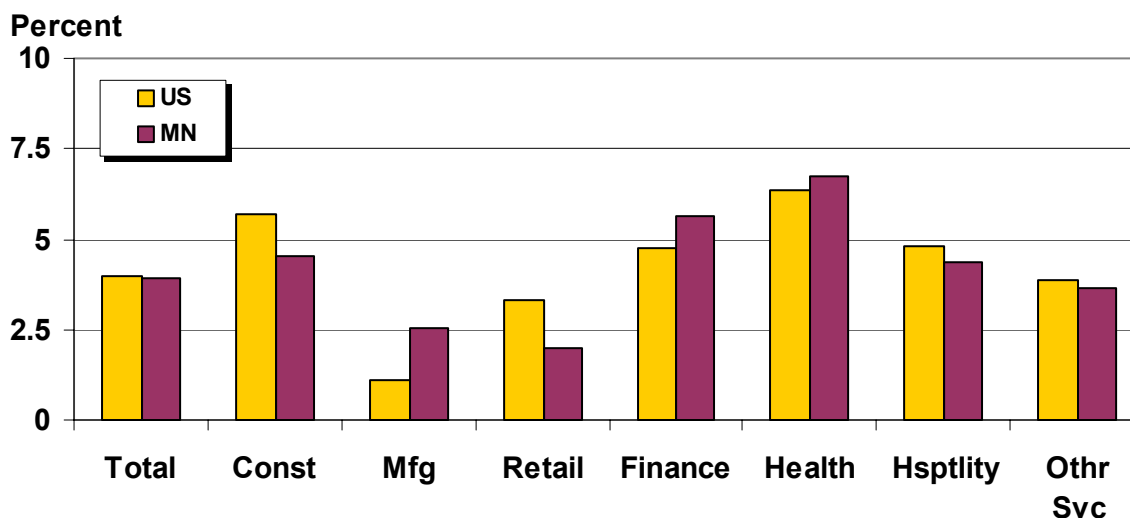
Minnesota Personal Income Grew at the U.S. Average Rate between 2000-2005

Recently released estimates by the U.S. Department of Commerce show Minnesota personal income totaled \$191.6 billion in 2005, 17th highest among all states. Between 2000 and 2005 Minnesota personal income grew at almost exactly the same rate as the nation as a whole. Personal income growth in Minnesota averaged 3.93 percent during that five-year period; the U.S. average was 3.96 percent.

Per capita personal income in Minnesota was \$37,322 in 2005, 9th highest in the nation. Historically, per capita personal income in the state has grown faster than the U.S. average. From 1960 through 2005 per capita personal income grew at an annual rate of 6.6 percent. The U.S. average was 6.2 percent. Between 2000 and 2005 personal income per capita in Minnesota grew at an average annual rate of 3.1 percent, 0.2 percent more than the U.S. average. Between 2004 and 2005, however, Minnesota lagged much of the rest of the country with per capita personal income growing by 3.1 percent, 1.1 percent less than the U.S. average.

Manufacturing, finance, and health care are among the major sectors where personal income in Minnesota has grown faster than nationally. Construction, retail, the hospitality industry, and other services are sectors where income growth has lagged that in the rest of the country.

Personal Income Growth by Sector, U.S. and Minnesota, 2000-05



Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	Fiscal Year 2006			Fiscal Year 2007		
				July - September 2006		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<u>Individual Income Tax</u>						
Withholding	5,482,800	5,544,304	61,504	1,337,000	1,335,675	-1,325
Declarations	1,357,400	1,408,538	51,138	277,759	277,831	72
Miscellaneous	848,200	917,962	69,762	69,822	63,927	-5,895
Gross	7,688,400	7,870,803	182,403	1,684,582	1,677,433	-7,148
Refund	1,084,230	1,007,850	-76,380	36,505	29,510	-6,996
Net	6,604,170	6,862,953	258,783	1,648,076	1,647,924	-152
<u>Corporate & Bank Excise</u>						
Declarations	970,699	994,099	23,400	228,600	300,704	72,104
Miscellaneous	125,940	166,778	40,838	29,612	32,764	3,152
Gross	1,096,640	1,160,878	64,238	258,212	333,468	75,256
Refund	140,700	99,251	-41,448	25,200	24,533	-667
Net	955,940	1,061,626	105,687	233,012	308,935	75,923
<u>Sales Tax</u>						
Gross	4,682,900	4,680,645	-2,255	1,045,160	1,020,253	-24,907
Refunds	214,538	217,003	2,465	55,516	47,387	-8,129
Net	4,468,362	4,463,642	-4,720	989,644	972,866	-16,778
<u>Motor Vehicle Sales Tax</u>						
	249,750	249,640	-110	65,953	68,032	2,079
<u>Other Revenues:</u>						
Inherit/Gift/Estate	210,000	215,933	5,933	22,750	31,644	8,894
Liquor/Wine/Beer	69,360	72,020	2,660	14,186	14,155	-30
Cigarette/Tobacco/Cont Sub	191,018	211,128	20,110	52,135	46,648	-5,486
Deed and Mortgage	294,700	310,587	15,887	52,978	58,172	5,194
Insurance Gross Earnings	287,700	274,728	-12,971	63,900	62,729	-1,171
Lawful Gambling	52,446	55,794	3,348	11,116	9,768	-1,348
Health Care Surcharge	205,204	205,266	62	51,435	51,883	448
Other Taxes	2,889	7,733	4,844	240	204	-36
Statewide Property Tax	629,977	631,279	1,302	93	237	144
DHS SOS Collections	47,134	54,696	7,562	13,902	11,445	-2,457
Income Tax Reciprocity	56,802	56,802	0	0	0	0
Investment Income	40,000	54,791	14,791	3,667	18,549	14,883
Tobacco Settlement	179,060	180,790	1,730	0	193	193
Departmental Earnings	290,800	307,094	16,294	48,570	51,937	3,367
Fines and Surcharges	100,400	130,801	30,401	19,258	19,806	547
Lottery Revenues	50,002	55,631	5,628	7,127	2,635	-4,493
Revenues yet to be allocated	0	0	0	0	1,243	1,243
Residual Revenues	96,327	72,304	-24,022	12,485	7,328	-5,156
Sales Tax Rebates (all years)	0	-2	-2	0	1	1
County Nursing Home, Pub Hosp IGT	27,792	30,227	2,435	1,698	1,698	0
Other Subtotal	2,831,611	2,927,602	95,991	375,539	390,276	14,737
Other Refunds	50,408	55,111	4,703	5,684	8,087	2,403
Other Net	2,781,203	2,872,491	91,288	369,855	382,190	12,334
Total Gross	16,549,300	16,889,568	340,267	3,429,445	3,489,462	60,017
Total Refunds	1,489,876	1,379,216	-110,660	122,905	109,516	-13,389
Total Net	15,059,424	15,510,352	450,927	3,306,540	3,379,947	73,407